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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Accounting for Judgments and Other Costs Associated with Litigation	CC Docket No. 93-240

COMMENTS OF
MCI TELECOMMUNICATIONS CORPORATION

MCI Telecommunications Corporation (MCI) hereby comments regarding the Federal Communications Commission's (FCC's or Commission's) Notice of Proposed Rulemaking, FCC 93-424, 8 FCC Rcd ____, released September 9, 1993 (Notice), which proposes accounting rules for treatment of litigation costs incurred in cases involving violations of federal antitrust laws and other statutes. The Notice is in response to a D.C. Circuit decision vacating and remanding the FCC's Litigation Costs decisions, which had established accounting rules and ratemaking policies for treatment of litigation costs.[1/]

I. Introduction

MCI agrees with the Commission's general premise that a carrier should not be able to recover from ratepayers the penalties assessed against it and other litigation costs incurred

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1/ Part 31 Uniform System of Accounts for Class A and Class B Telephone Carriers to Account for Judgments and Other Costs Associated with Antitrust Lawsuits, and Conforming Amendments to the Annual Report Form M, Report and Order, 2 FCC Rcd 3241 (1986), reconsidered, 4 FCC Rcd 4092 (1989), vacated and remanded sub nom., Mountain States Tel. and Tel. Co. v. FCC, 939 F.2d 1035 (D.C. Cir. 1991).

in connection with its violations of the law. As a matter of public policy, the Commission should presume conclusively that violations of federal law are not in the public interest. Congress devises legislation directing certain corporate conduct that it determines will be in the public interest. Therefore, compliance with those laws should be presumed to be in the interest of the public, while violations of those statutes logically can be considered to be against the public interest, and by extension against the interests of interstate ratepayers.

The Commission is charged with protecting the interests of interstate ratepayers and, in the usual conduct of its authority, it balances the interests of ratepayers against the interests of shareholders of the regulated carriers. The Commission balances these interests when it conducts a review of the carrier's rates and when it makes a determination of what costs or investments should be included in or excluded from the ratebase. In remanding the previous litigation costs decisions, the D.C. Circuit noted that "it is a legitimate aim of rate regulation to protect ratepayers from having to pay charges unnecessarily incurred, including those incurred as a result of the carrier's illegal activity...". 939 F.2d at 1043.

The costs of judgments, settlements and other litigation expenses should be seen as no less a part of that analysis than, for example, the costs of plant construction. The Commission's long-established rules appropriately recognize the inequity of requiring current ratepayers to bear the cost of future

construction. See American Tel. and Tel. Co. -- Charges for Interstate Services, Docket No. 19129, 64 FCC 2d 1, 60 (1977), reconsidered 67 FCC 2d 1429 (1978), aff'd Illinois Bell Tel. v. FCC, 911 F.2d 776 (D.C. Cir. 1990).

Furthermore, in determining whether costs should be excluded, regulators routinely analyze the costs in terms of whether they are "used and useful" to the ratepayers. See e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). To be fair to ratepayers, the Commission should not allow carriers to charge ratepayers for any expenses that cannot be considered used and useful in the provision of telecommunications services. To allow otherwise would be contrary to the public interest. Thus, adverse judgments, settlements and other litigation costs related to violations of federal statutes should be presumptively excluded from the ratebase because they are not used and useful to ratepayers.

II. The Commission Is Correct in Presumptively Excluding Adverse Judgments from the Ratebase.

The Notice proposes to require that antitrust judgments be recorded in a nonoperating account, specifically account 7370, Special Charges. The Commission states that costs recorded in account 7370 are given special regulatory scrutiny, and are presumptively excluded from costs of service in setting rates.

MCI supports this proposed treatment of antitrust judgments[2/] and also supports presumptive exclusion for judgments assessed in connection with violations of other federal statutes. These expenses are not incurred for the benefit of ratepayers and should not be routinely passed on to ratepayers. This principle was confirmed by the D.C. Circuit's indication that "the FCC may disallow any expense incurred as a result of carrier conduct that cannot reasonably be expected to benefit ratepayers." 939 F.2d at 1043. As stated above, such costs cannot be considered used and useful in the provision of telecommunications services.

As the Commission notes, the carrier would have the opportunity, in a rate case, to demonstrate that ratepayers derived a benefit from the behavior that gave rise to the lawsuit. Notice at 3, ¶ 10. Therefore, before being allowed to include litigation judgments in its ratebase, the carrier violating federal law bears the burden of demonstrating how its wrongdoing produced a benefit for ratepayers. To adopt any other policy would provide the carrier with no economic incentive to obey federal statutes.[3/]

When a nonregulated business violates the law, any loss suffered as a result of an adverse judgment would be a loss to

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[2/] MCI would support the extension of the policy to treatment of expenses incurred in litigating state antitrust lawsuits. The Court seemed to agree that the rationale for disallowing recovery of these expenses for federal cases would apply equally to state cases. 939 F.2d at 1034.

[3/] Moreover, a carrier's management is more likely to settle a case of low merit if it knows that the company's ratepayers may ultimately bear the economic loss of costly litigation.

the corporation's bottom line. Thus, its shareholders would bear the risk of monetary loss. Conversely, the regulated carrier would have no risk to bear for violating federal law if it knew that any loss suffered would be chargeable to the ratepayer.[4/] It would be against the public interest for the Commission to create a perverse incentive to violate federal laws.

The Notice asks whether and how the Commission can extend these litigation cost exclusion rules beyond the antitrust context to lawsuits involving violation of federal statutes in which the actions did not benefit ratepayers. Notice at 4-5. MCI agrees with the Commission's interest in extending the policy to violations of other federal statutes. The public interest in not allowing recovery of expenses which produce no benefit for the ratepayers is equally valid in connection with violations of nonantitrust federal statutes. The Commission would appear to be on the strongest ground when extending this disallowance policy to cases involving violations of the Communications Act, enforcement of which the Commission clearly has authority.[5/] 47 U.S.C. § 208. It would be an egregious abuse of the ratemaking process for a carrier to be able to recover the expenses it incurs in a case brought by ratepayers to redress the carrier's

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[4/] The incentives are applicable to carriers under price cap regulation as well, regardless of the sharing provisions. 47 CFR § 61.45(c)(2) (1992).

[5/] MCI notes that the D.C. Circuit seemed troubled by possible extension of the policy beyond the context in which the Commission has some statutory authority for enforcing compliance with the law. 939 F.2d at 1042-46.

violation of the Communications Act. Moreover, it is difficult to imagine a situation in which a carrier would be able to prove that violating the Communications Act produced a benefit for ratepayers.

The Commission requests comment on how the Litton case might affect the reinstatement of litigation cost recovery rules. Notice at 5. The primary regulatory error for which the Commission's decision was remanded was not the disallowance, per se, but the disallowance after having allowed the expenses to be claimed in an operating account.[6/] The proposal under examination here should avoid the problem which caused that court to overturn the Commission's disallowance because it places the amounts into a nonoperating account. In fact, the Litton court recognized that the Communications Act imposes upon the Commission the duty of regulating the rates chargeable for interstate telecommunications service with a view to ensuring that they are just and reasonable. 939 F.2d at 1029, citing 47 U.S.C. §§ 201-201. Further, the court noted that regulatory authorities may disallow expenses actually incurred in the company's operation when the challenged expense is found to be exorbitant, unnecessary, wasteful, extravagant, or incurred in the abuse of discretion or in bad faith; or when the cost is

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[6/] The Litton court vacated the Commission's disallowance of judgment and litigation expenses based on the prinicple of retroactive ratemaking. Mountain States Tel. and Tel. Co. v. FCC, 939 F.2d 1021 (1991). The court appears to have been offended because the Commission had allowed AT&T to claim the costs of the Litton litigation "above the line" but later directed AT&T to move those costs "below the line" and disallowed recovery.

nonrecurring in nature. 939 F.2d at 1029.

III. The Commission Is Correct in Excluding Settlements from the Ratebase.

The Notice also proposes to require carriers to record antitrust settlements in account 7370 to be given special regulatory scrutiny and presumptively excluded from the ratebase. In the Notice the Commission states that the Court agreed with the FCC's approach to treating antitrust settlements as nonoperating expenses, so as not to create an incentive to settle (possibly for more than the amount of potential liability) simply to receive a preferable accounting treatment. Notice at 3, ¶ 11.

MCI supports the placement of settlements into a nonoperating account and allowing the carrier to assume the burden of showing how the settlement was in the public interest. MCI believes that settlements, whether prejudgment or postjudgment, should be excluded from the ratebase, except when a particular carrier can demonstrate that it was in the interest of ratepayers to settle the lawsuit. Otherwise a carrier who becomes aware that an adverse judgment is imminent may settle for any amount just to qualify the payment as a settlement for inclusion in the ratebase.

MCI shares the Commission's concern that ratepayers may pay to settle some cases in which the adverse judgment might have been upheld on appeal. However, holding the settlement amount in a nonoperating account and requiring demonstration of public benefit should allay this concern because the carrier could not

assume that it would automatically be allowed to recover the settlement from ratepayers.

MCI agrees with the Commission's attempt to create an incentive for carriers to settle lawsuits early rather than carrying the case through to judgment and then seeking recovery from the ratepayers. Early settlement would be in the interest of ratepayers because the amount to be recovered from ratepayers would undoubtedly be smaller than the amount required to fully litigate the case.

The Notice seeks comment on whether the Commission should reinstate a vacated policy which would have allowed a carrier to include in its revenue requirement the "nuisance value" (the amount of litigation costs avoided by settlement) of the lawsuit if settlement were reached prior to judgment. MCI believes that the carrier should not be allowed to presumptively recover from ratepayers the so-called nuisance value of the lawsuit. For the same reasons the underlying judgment should not be allowed, neither should any nuisance value settlement be recoverable. The Commission's proposed accounting treatment would not discourage settlement since it can be assumed that the settlement amount would be significantly less than the ultimate judgment. Therefore, it would be consistent with the D.C. Circuit's conclusion, in the remand case, that denying recovery of the nuisance value for postjudgment settlements may create an incentive to appeal an adverse judgment. 939 F.2d at 1039-40.

In the event, however, that the Commission reinstitutes a

policy allowing for recovery of prejudgment nuisance value from ratepayers, MCI recommends establishing a very low dollar threshold amount for what would be considered the "nuisance value." A carrier settling a case for an amount under the threshold could file the settlement with the Commission and would be allowed to include the settlement in the ratebase.

IV. Other Litigation Expenses Should Be Accrued in a Deferral Account.

The Commission proposes requiring carriers to accrue other expenses related to antitrust litigation in a deferral account (account 1439) until the case is resolved. Upon entry of an adverse, nonappealable final judgment or postjudgment settlement, these expenses would be charged to account 7370. If the case were resolved in favor of the carrier, the expenses would be amortized above-the-line for a reasonable period. The Notice proposes similar treatment for antitrust expenses associated with prejudgment settlement, i.e., they would be booked in account 1439 as operating expenses.

MCI agrees that this is a rational approach for treatment of other antitrust litigation expenses and encourages the Commission to extend this accounting treatment to litigation expenses incurred in nonantitrust cases. The Court appears to have found the previous rule offensive because it allowed expenses to be placed into a recoverable account and then later recaptured those expenses for exclusion. 939 F.2d at, 1029-30. Placing the amounts into a deferred account should avoid the retroactive

ratemaking problem because carriers could not presume that these expenses would be recoverable.

The Commission proposes to allow antitrust litigation expenses charged to account 1439 to be booked in operating accounts in the event of a prejudgment settlement. The Notice asks commenters to address the effects that this accounting deferral may have on carriers' incentives to settle. MCI agrees with the Court's indication that this approach may provide an incentive for carriers to settle prior to judgment to recover some portion of litigation expenses.

VI. Conclusion

MCI urges the Commission to adopt its proposals to treat antitrust judgments and settlements as presumptively excluded from the ratebase and encourages the Commission to extend this accounting treatment to judgments and settlements in connection with violations of other federal statutes. Other expenses associated with such lawsuits should be accrued in a deferral account to be disposed of after conclusion of the lawsuit.

Respectfully submitted,

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